Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

APPENDIX

Supreme Court of the United States

October Term, 1977

No. 76-1835

IKE SLODOV,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petition for Certiorari Filed June 23, 1977
Certiorari Granted October 3, 1977

TABLE OF CONTENTS

Relevant Docket Entries 1

Transcript of Testimony:

James R. McLaughlin—

Direct Examination 2

William J. Molchan—

Direct Examination 3

Cross Examination 8

Re-Direct Examination 12

James R. McLaughlin—

Direct Examination 15

Dr. Ike Slodov—

Direct Examination 15

Re-Cross Examination 16

James R. McLaughlin—

Direct Examination 17

Opinion of the District Court (Bankruptcy), Judge Don C. Miller 18

Judgment of the District Court (Bankruptcy), Judge Don C. Miller 38

Memorandum Opinion and Order of the District Court, Judge Thomas D. Lambros 39

Judgment of the District Court, Judge Thomas D. Lambros 46

Opinion and Judgment of the Court of Appeals for the Sixth Circuit 47

Order of the United States Supreme Court Granting Petition for a Writ of Certiorari 59

No. B 70-4787

United States District Court

NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN THE MATTER OF

IKE SLODOV,
Debtor

RELEVANT DOCKET ENTRIES

July 1, 1974	Opinion of the District Court (Bankruptcy), Judge Don C. Miller.
September 9, 1974	Judgment of the District Court (Bankruptcy), Judge Don C. Miller.
September 8, 1975	Memorandum Opinion and Order of the District Court, Judge Thomas D. Lambros.
September 9, 1975	Judgment of the District Court, Judge Thomas D. Lambros.
April 5, 1977	Opinion and Judgment of the Court of Appeals.
June 23, 1977	Petition for a Writ of Certiorari Filed.
October 3, 1977	Certiorari Granted.

TRANSCRIPT OF TESTIMONY

No. B 70-4787

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

(Title Omitted in Printing)

* * * * *

[23] JAMES R. McLAUGHLIN called as a witness on behalf of the Debtor, being first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION OF JAMES R. McLAUGHLIN

By Mr. Carlisle:

Q. Mr. McLaughlin, would you state your full name and address, please? A. James R. McLaughlin, 1210 Bell Avenue, Lakewood, Ohio.

Q. And your position? A. I am a Revenue Officer with the Internal Revenue Service.

Q. Are you familiar with the filing of the various claims in the real estate arrangements provision of Ike Slodov? A. Yes.

* * * * *

[38] Q. You told them in no uncertain terms that current withholding taxes and withholding Social Security had to be paid? A. And I might add that we did that even in the face of the liabilities being old. The first thing we were concerned with was that no more taxes were being accrued.

Q. That's right, and was the intent stated to you that the current withholding, as it accrued, both taxes

and Social Security was going to be paid? Isn't that correct? Didn't they tell you that? A. Yes, they would have told me that certainly.

* * * * *

[81] WILLIAM J. MOLCHAN called as a witness on behalf of the Government, being first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION OF WILLIAM J. MOLCHAN

By Mr. Mitchell:

Q. Would you state your name and present address? A. William J. Molchan, M-o-l-c-h-a-n, 3201 Wales Avenue, Parma, Ohio.

Q. By whom are you presently employed? A. Zagar Tool.

Q. How long have you been with them? A. Almost four years.

Q. Were you involved in the business known as either Tas-tee Catering or Russell's Foods? A. Was I involved?

Q. Yes. A. Yes, I was.

Q. For what period of time? A. A little over a year, from around the 1st of March of '68 until June 1st or 4th of '69.

Q. Do you recall when Dr. Slodov came into the business? A. Yes, I do.

Q. When was that? **[82]** A. January 31st of '69.

Q. As you understand it, how did he come into the business? A. We were called in by Russell Pishnery and advised that the company had been sold to Dr. Slodov and his associates, and at that point in time a couple of members of the new group were introduced, but I don't believe Dr. Slodov was at that point.

I don't recall meeting him until a few days later.

Q. What was your role in the business? A. I was accounts payable supervisor primarily, the title I had, but generally speaking, I was paying bills.

Q. You are basically an accountant then? A. Yes, I am.

Q. How would you describe the role that Dr. Slodov played in this business? A. He was the principal.

Q. He was the principal? A. Absolutely.

Q. If you could be a little more specific, what did he do? What decisions would he make? A. Well, Dr. Slodov, the first few days I was under the direction of Mike DiDomenico who was still [83] exercising authority over the office, and although I had seen Dr. Slodov around, I really didn't know his name.

I didn't know which gentleman was Dr. Slodov, and then about a week later I met Dr. Slodov in his office on a Sunday, and he advised me he wanted me to remain. We worked with them, and he would be in charge of all my future directions rather than Mike.

* * * * *

[84] Q. Mr. Molchan, you were describing a meeting you had on a Sunday with Dr. Slodov and what he told you. A. He just introduced himself and said who he was and said he was going to function as the leader. I was going to be working with him, and he was going to retain my services, and generally, asked me to cooperate with him and try and do what I could to help.

Then they had another meeting which I went out and attended that same day. That was the same day.

Q. Did you subsequently take direction from Dr. Slodov? A. Yes. Dr. Slodov and Mr. Catania. Dr. Slodov wasn't there every day, because he had a practice, and sometimes he contacted me by phone. Sometimes he left [85] me a note and sometimes came through Mr.

Catania or Mr. Surckla, but I was advised generally any desires he had that he wanted me to do.

Q. Were you ever given a direction as to what creditors would be paid and what creditors were not to be paid? A. Almost immediately the direction was to pay the bills due. First a list would be made up daily, and this entered another gentleman, I think Mr. Mellinger made this, if I recall correctly, a list of what we needed, and these were primarily the bills we would meet.

We were paying for those bills because things were difficult and we weren't able to get merchandise freely, so there was a list with what was needed from different vendors, so we had a list of the amount that we could afford to pay to get the merchandise, and Dr. Slodov was involved in that, as were all of us, I suppose.

Q. And it was your job to then try to pay these creditors? A. That's correct.

Q. In order to obtain merchandise? A. That's correct.

Q. Are you generally familiar with the provisions [86] in the Internal Revenue Code for payment of FICA taxes and withholding of employees, withholding of FICA taxes? A. I am.

Q. And for the withholding of federal income taxes? A. Yes, I am.

Q. Who in the business was responsible for withholding and collecting for those taxes? A. We were withholding them in the Payroll Department, and in the beginning Dr. Slodov had—

Judge Miller: Just a moment. The Court would like to know what period of time you are talking about.

Mr. Mitchell: I'm sorry.

Q. Let's limit this in this case between January 31st and July 15th, or more specifically, the time you left,

which was the first week in June. A. Well, to begin with, it seemed like we were totally aware for the need to provide for taxes, so incorporated in the list, we always said, Dr. Slodov said we needed to set aside certain funds, as much as possible, and he had designated certain amounts, maybe $300 a week for this or whatever, to be provided to pay income taxes, so when we did fail our 941's, the funds would be there. So we endeavored to set up [87] different accounts other than the National City accounts where we would apply a few hundred dollars at a time.

Now, generally speaking, this is not easily done due to the circumstances of the corporation at the time.

Q. Go into those circumstances a little more. A. If we wanted to pay a tax on a given day and we couldn't quite come up with the money because we either didn't collect it or we had an emergency need for some kind of merchandise, we would defray the payment of the tax at that point, because we really didn't owe it at that point. The corporation didn't really feel they owed it at that point because the tax is next week, and they would buy something and then next week they would endeavor to do something about it.

This was a struggle, but provided in the whole thing that taxes were—we were going to have this to meet them, and by and large they were always included in the list, but not always paid according to the list.

Q. You left the business in June of '69. Would you describe the conditions under which you left? A. Well, I wasn't always in agreement with the way money should be paid or not paid, and at this [88] particular time there was a period of time when Dr. Slodov was not in charge of the corporation according to, you know, the other officers, and an emergency arose; wherein, we either had to spend money for taxes or spend money for merchandise, and the people involved, meaning the other officers other than Dr. Slodov had decided that they were going to close the plant or some such decision and had advised me that we are going to pay the payroll and the taxes and close up.

At this point in time there was a meeting; wherein, Dr. Slodov didn't want to close the plant, and he signed some affidavit— I don't have the information exactly— but it was to the effect that he was taking over and being responsible for the liability of the taxes, et cetera.

We went out to Mr. Carlisle's house one evening and this was consummated and signed by Dr. Slodov, that he would be responsible for all liabilities and whatever they were at the point, and we tried to talk him out of it.

I don't know exactly what it said, but to the effect that he was going to take over the responsibility, and it was shortly or the next day or so, that Dr. Slodov asked me to take a vacation, and I didn't want to take it, at least I didn't want to take a [89] vacation.

I either had to stay on and do what I could or get out, and I quit. I didn't come back other than to pick up my stuff.

Q. You indicated that you said that money had to be used to pay taxes or otherwise. Was there a fund of money actually accumulated? A. We did have some funds. There was some that Mr. McLaughlin alluded to in the Lake County Bank. We had, downstate, like in Akron and Canton, depositing funds, and we left them set there as long as possible, so when the quarterly return would be filed, that is what we did the first quarter, and we applied those to the residue of the balance due. We applied it when we filed in April, and we were trying to do the same thing, as a matter of fact, with the downstate funds, Dayton, Akron, Canton area, and I recall there was about $30,000 involved in this deal that occurred around the 1st of June, and how to use it became a problem.

Q. What did Dr. Slodov want to do with the money? A. I assume he bought merchandise.

Q. Do you know what he wanted to do with the money? A. I think he wanted to buy merchandise. He [90] wanted to keep the place open.

Q. Do you, in fact, know what became of the money? A. No, I do not.

Mr. Mitchell: Your Honor, I don't have any further questions of Mr. Molchan.

CROSS EXAMINATION OF WILLIAM J. MOLCHAN

By Mr. Carlisle:

Q. Mr. Molchan, you indicated that you had charge of the accounts payable. You had that struggle? A. That is certainly true.

Q. One of the things we are talking about, Mr. Molchan, is a preference of other creditors over paying Internal Revenue. Do you recall any creditors who were given preferential payment? A. Nobody was given preferential payment, only merchandise bought, but not preferentially.

Q. You don't recall bringing anybody current on installment payments? A. Nobody was brought current.

Q. Or payment of license plates that were a year old? A. Nobody was brought current.

Q. Do you recall actually what happened between [91] February and July or February and the time you left? Let's refer to some specifics. You had a monthly obligation in the neighborhood of $8 or $9,000 to Union Bank and Commerce? A. We didn't pay it.

Q. They held a pledge of stock of the Charles Corporation, didn't they? A. Correct.

Q. First National Bank of Canton, there was an obligation down there. Do you recall if they were paid regularly? A. Not regularly.

Q. Cleveland Trust, you had a very sizeable equipment loan there; isn't that correct? A. Positively.

Q. Do you know what condition they were left in? A. Extremely bad. They made a levy.

Q. Do you recall Horton Dairy? What was Horton Dairy? A. As I recall, some $80,000.

Q. They took judgment for it, didn't they? A. Yes.

Q. Did you make any preferential payment to them? [92] A. Not other than say four percent beyond what they were producing or some such thing.

Q. Do you recall a $100,000 payment to a company by the name of Metropolis Industries? A. I know of it.

Q. Do you recall how that loan came about? Do you know when it was? A. Let me explain first that I was not directly involved in that general ledger area. It was Mike DiDomenico's responsibility, but when the loan was taken, it was at a time when taxes were due also, and I—

Q. Withholding taxes? A. Withholding taxes, and I always heard from Mike that this was an absolute type note, and was like a hammer over the corporation.

I never saw the note, and I never heard any more about that note until after Mike left.

I got one of these sheets like that one there, a legal size paper, that had it itemized on that as a payment in the first week in February, in 1969, and frankly, I was floored at $100,000 going out at that point.

I don't know who made the decision. I don't know who signed the check, but I do know they paid [93] $100,000 in the first week in February to this company.

Q. By an absolute type, what do you mean? You were not implying any mafia or anything of that nature? A. Not to my knowledge.

Q. What about National City Bank? They had a demand loan, didn't they, for $250,000? A. I really

didn't get into that until after Mr. McLaughlin came out and things got really tough, because apparently that was handled in December by the doctors involved in the prior ownership, and there was a $225,000 note involved there.

Q. Do you remember what that was taken out for in December? A. I would think it covered the overdraft of 1968, third quarter payment of taxes.

Q. And do you recall, as the accounts payable accountant there, do you recall paying anything on that National City Bank loan? A. No, I do not.

Q. Mr. Molchan, you indicated that a list was set up by Dr. Slodov to make deposits or set aside funds on a daily basis, and that included on that list was money for withholding taxes. A. That's correct.

Q. But this is money, you were setting aside **[94]** money in advance here, is that correct? A. That's correct.

Q. So in other words, this money you were setting aside was actually being set aside on a daily basis prior to a payroll withholding; isn't this correct? A. If I may clarify, we didn't physically set aside money. The catering business and the vending business had a numerous number of banks that they were depositing rather than carrying them in the central depository there, and we didn't transfer certain funds to the distribution center in order to leave them there for payment of taxes.

That is the way we really left it there. We didn't take a check and write $100 to bank so and so. We didn't transfer the funds to be used to—

Q. What you were doing then was segregating or withholding those funds from the National City Bank, generally disbursing or a general account? A. That's correct.

Q. And this was part of the original plan that was set up? A. That's correct.

Q. And as far as you know, to the best of your ability and to the best of Ike Slodov's ability, **[95]** was an attempt made to follow through on this plan? A. There was an attempt.

Q. And in fact didn't it get to a point in March and in April and May where despite the plans that had been set up, your checks started bouncing on a National City Bank account? A. Yes.

Q. Do you recall what caused that? A. Well, the first time we had trouble with it was over the milk bill. When they took some judgment, National City grabbed the funds that they had there and we couldn't use the account. It was several days of problems there where we were using the cash right out of the till there, right out of the collection to buy whatever we were using at the point that we needed it. There was no way we could transfer. This precipitated a problem, wherein, we could not use checks very effectively unless we were in the bank seven days. They wouldn't just accept a payment check, so people began asking for certified checks, and in some ways that is how we gave many of our checks to the IRS, in certified form, taking cash down in cars to deliver to National City to get a check to pay. We did that not only with IRS but with other people as well.

Q. So in following again this general scheme **[96]** of daily or weekly or setting aside money and actually depositing money to pay Internal Revenue withholding, you got to the point where then you had to change your cash and currency into certified funds, and then take those checks down to Internal Revenue; is that correct? A. That is after the lien of the IRS, put a lien on, and after that we pretty much operated on almost a cash basis, because we couldn't get checks—no one would accept our checks.

Q. Do you recall how long a period of time this went on? A. I do believe that was probably the last month I was there. It started—I wish I could remember it—May 8th is very important to me because it is the day the check didn't clear the bank. We issued, I think, it was May 8th when it really got bad, and the whole month of May was bad.

Q. You were a corporate treasurer during this period of time, were you not? A. Yes.

Q. Did you receive anything other than your normal salary? A. No, sir.

Q. Was there an occasion or two when you didn't receive your salary? **[97]** A. Yes, sir.

Q. You are still carrying a check around? A. Yes, sir.

Q. It has never been cashed? A. Never will be.

Q. Do you recall what pay period that was for? A. It was one of the ones where we couldn't make the payroll. I got paid for the last one.

Mr. Carlisle: I have nothing further.

Mr. Mitchell: May I ask a couple more questions?

Judge Miller: Yes.

RE-DIRECT EXAMINATION OF WILLIAM J. MOLCHAN

By Mr. Mitchell:

Q. You said monies were set aside in the outlying banks. A. Yes, sir.

Q. What became of those monies? A. Well, in a couple of instances, they were closed out by the IRS, and we didn't go any further with that because we had gotten to the point where we couldn't use a check anyhow to transfer anything else. The banks would grab them,

so we began to take cash **[98]** monies back and forth. There were some funds that might have been down in Akron or Canton. I don't know how far Mr. McLaughlin went with his lien.

I know we were surprised when we hit Lake County, because we had a check out there that didn't go, and there were funds there for it.

I don't remember what it was, but some kind of payment, and then we had a bank account in Cleveland Trust, I think they liened on, and took the funds, so these deposits in the outlying areas were basically—they didn't get very far.

You have got to realize we are talking about a short period of time. I think Jim McLaughlin showed up on the 10th or 11th of April, and by May 9th or 10th we were in bad condition, because he made his moves on liens and what have you, and the incidents of the milk company had done us no good.

So checks were not very viable at that point in time. We were handling cash extremely dangerously, Mr. Surckla particularly involved.

Q. Let me get this straight. Was it not until then when Mr. McLaughlin came out that this effort was made to withhold the checks? A. No. We made some payment prior to that. See, we did make some payments in February and in March **[99]** of these funds. They have the figure, but as we went along, we made some payments of the funds and we would transfer them into National City Bank and write a check, and I would tell Mr. Williams that these were funds we were going to pay out into Internal Revenue.

We tried to follow a pattern until we couldn't do it anymore, but in the early stages, like when we paid $5,000, and I recall the incident when Mr. McLaughlin came out and we gave him two checks for $5,000, each

for two different corporations, these were part of the funds we set aside, and later we made more payments. They weren't even amounts because whatever we transferred, we got a check or cash for it.

Q. Incidentally, you spoke of a Mr. Williams. Now, that is a gentleman in the bank? A. Yes.

Q. He is not a Revenue officer? A. No, sir.

Q. You had also indicated to Mr. Carlisle that you brought none of your creditors currently—I believe that was your phrase. A. None of our creditors were current.

Q. Right. During the period, again January 31st to your departure, were payments made of some bank debts to your suppliers? **[100]** A. We endeavored. There was an agreement made with our suppliers that those who were—and I assume it was most of them—that when we did make a check out, we would endeavor, I think it was a four percent return on what was past due.

This agreement was made. It was extremely difficult to live with. We just couldn't live with that. It was part of the problem.

We couldn't pay those kinds of back bills, but the officer in charge of that particular negotiation made those terms, and some of them made us live with it. We couldn't get anything unless we paid it that way.

Q. And we have been speaking of daily or weekly deposits. How much money would the business deposit in a week? A. After January 31st it ran about $130,000.

Q. A week? A. Yes. It deteriorated later, but during the month of February, I would say, and probably March, it ran $130,000. Then it went downhill.

Mr. Mitchell: That completes my questioning.

Mr. Carlisle: Nothing further.

• • • • •

[127] JAMES McLAUGHLIN was recalled as a witness, being previously duly sworn, was examined and testified further as follows:

• • • • •

[135] DIRECT EXAMINATION OF JAMES McLAUGHLIN

By Mr. Mitchell:

• • • • •

[144] Judge Miller: And you told the corporate officers to pay, to keep the taxes current?

The Witness: Yes.

Judge Miller: You didn't tell them just to pay the trust fund portion?

The Witness: No.

• • • • •

[154] DR. IKE SLODOV was called as a witness, being first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION OF DR. IKE SLODOV

By Mr. Carlisle:

Q. Dr. Slodov, would you give your full name and address, please? A. Ike Slodov, 30026 Gates Mills Boulevard, Pepper Pike.

Q. Your occupation? A. Orthodontist.

Q. How long have you been an orthodontist? A. 12 years.

Q. Bringing your attention, Dr. Slodov, to the purchase of the stock of Russell's Foods or Tas-Tee Catering in January of 1969, did you sign a purchase agreement to purchase the stock of Tas-Tee Catering? A. Yes, I did.

• • • • •

[270] RE-CROSS EXAMINATION OF DR. IKE SLODOV

By Mr. Mitchell:

* * * * *

[272] Q. Please. A. On February 3rd, when we called the Service on the 11th, when we talked to them, if they at that [273] time had said, "Hey, let's stop everything," and we went there and had a meeting and we sat down and talked about football and who was best and who was worst, and we spent maybe three hours there all morning. Right there they had a choice. They could have told us: "Hey. You can't do anything but pay us."

We would have done just that or else we wouldn't have gone on, but they told us: "Hey. Go and operate the business. Do the best you can and we will go along with what you say."

What did we say we were going to do? We said we were going to take monies and make the deposits, and we were going to try to set monies aside towards the back taxes.

That is what they told us to do. That is what we went and did. Then the Metropolis Industries thing came up. We were told—

* * * * *

[294] JAMES McLAUGHLIN was recalled as a witness, being previously duly sworn, was examined and testified further as follows:

DIRECT EXAMINATION OF JAMES McLAUGHLIN

By Mr. Mitchell:

* * * * *

[310] Q. You were describing your discussions with the taxpayer and paying off current taxes.

Would you state again what you had instructed or requested or indicated to the corporation insofar as current taxes are concerned? A. I would like to—

Mr. Carlisle: Excuse me. I missed the question. I am sorry.

Judge Miller: Will you repeat the question, Mr. Reporter?

(Question read.)

A. Again, of course, I have to have my memory serve me, and I can't specifically recall every little thing.

However, I can rely on what I would normally do, and I probably did it in this instance.

If in any kind of situation like this, this is certainly a jeopardy type of situation. We have got a large liability. We have got a corporation that accrued more liabilities, and there has got to be some judgment made as to what are we going to do with this.

[311] Well, the usual way we would approach these is that we will—I shouldn't say ignore, but we will set aside the delinquent liability for a moment to make sure there is no more liabilities accruing, and this would be the first thing we would do is to prevent any further liability.

* * * * *

OPINION OF THE DISTRICT COURT

(Filed July 1, 1974)

Case No. B70-4787

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN THE MATTER OF:

IKE SLODOV,
Debtor

In Proceedings for a Real Property Arrangement under Chapter XII

OPINION

STATEMENT OF FACTS

(Filed July 1, 1974)

Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee Vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.

During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient monies in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately. Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.

There was a provision in the agreement of sale whereby Ike Slodov agreed to hold harmless the four sellers from payment of certain tax liabilities of Tas-Tee Catering. The following is the provision of the agreement of sale:

> "Buyer shall hold Sellers harmless from and against all loss, liability, damage or expense arising out of any claims, demands, penalties, fines, taxes or other loss resulting directly or indirectly from the assertion against Russell's Foods, Inc. of claims by the Federal Government, State Government, County Government or City Government for taxes and assessments. Buyer expressly acknowledges their understanding that there is an obligation of Russell's Foods, Inc. to pay taxes in the approximate amount of $250,000.00 on or before January 31, 1969."

Debtor Ike Slodov introduced at the hearing of this issue Exhibit 7, wherein the same four selling shareholders

dismissed all claims against the debtor relating to such stock purchase agreement.

The Internal Revenue Service filed its proof of claim for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828)."

Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,-511.58, supplemental to proof of claim No. 29 filed on November 2, 1970.

The Issues

A) Is the claim of Internal Revenue Service based on the theory of third party beneficiary under the "hold harmless" paragraph of the agreement, wherein the debtor Ike Slodov agreed to hold four sellers harmless from payment of certain taxes of Tas-Tee Catering, a valid claim?

B) Were the acts of the debtor Ike Slodov intentional and willful under Section 6672 of the Internal Revenue Code?

Discussion of the Issues

> "As in the case of other types of claims, a filed proof of a tax claim in proper form establishes a prima facie case for the allowance of the claim. The burden of proof is on the claimant, but the burden of going forward and introducing evidence to rebut the prima facie case is on the objecting party. . ." *3A Collier on Bankruptcy*, §64.409.

The objecting debtor carried his burden of going forward to rebut the prima facie case as to each of the two claims.

Claim No. 80 in the amount of $229,511.58 is filed as an unsecured claim based on the theory of third party beneficiary under the agreement for sale of the Tas-Tee Catering stock wherein Ike Slodov agreed to hold four individual sellers harmless from payment of certain tax liabilities of Tas-Tee Catering and related companies.

The debtor Ike Slodov introduced Exhibit 7, wherein those same selling shareholders dismissed all claims against the debtor related to such stock purchase agreement. It should be noted that such persons acknowledged in Exhibit 7 that the so-called stock purchase agreement "shall be considered null and void."

It is well settled that "in order that a third person may enforce a promise made for his benefit, it must appear that the contract was made and entered into directly or primarily for the benefit of such third person." (11 *O. Jur 2d, 426, Contracts* §177; also see 17 *Am Jur 2d, 727,*

Contracts §304, entitled "Necessity of, and what constitutes, intent or purpose to benefit third person.")

The debtor Ike Slodov testified that when the agreement was signed, he had no intent to benefit the Internal Revenue Service and that the agreement was solely for the intended benefit of sellers and debtor personally.

Claimant offered no testimony or evidence whatsoever to carry its burden of proving the following:

1) That there is in existence a valid enforceable contract;

2) That provided there was a valid contract, there was intent to "directly or primarily" benefit claimant;

3) That it had valid claims against the sellers and had collected or had the ability to collect from such sellers, thereby invoking the hold harmless provision—again provided it were part of a valid agreement.

The evidence disclosed that the debtor took command of the company on January 31, 1969, and that there were numerous conferences in which the debtor emphasized that money should be set aside for the payment of taxes. Within five weeks thereafter, the debtor had deposited $42,000 in the Lake County National Bank for the purpose of paying Internal Revenue Service. At that time he called Internal Revenue Service stating that the $42,000 was in the Lake County National Bank for the purposes of paying the taxes. The next day Internal Revenue Service attached the $42,000. The debtor had charge of the company for less than six months, and at those periods he or his accountant had numerous conferences with Internal Revenue Service attempting to solve the problem of taxes.

A. *Claim No. 29—Withholding and FICA (personal) taxes in the amount of $445.69*

Debtor rebutted this personal claim by his testimony that he had never been notified of a deficiency claim on his withholding; that he had always paid his employees' withholding when due; that Internal Revenue Service had audited his withholding and personal tax returns through the claimed 4th quarter of 1969 and had determined a refund of $6,674.84 due him; that such refund had actually been held by Internal Revenue Service for application to one of the Tas-Tee accounts.

Debtor's independent accountant testified she had participated with an Internal Revenue Service agent in such audits and that no finding or claim had ever been made for such withholding and that as late as November 19, 1973, the date of the latest correspondence from Internal Revenue Service (debtor's exhibit 9), no claim had been made for such tax.

The United States failed to give any direct testimony or explanation of such tax claim and wholly failed to carry its burden of proof on such portion of claim no. 29.

B. *Claim No. 29 as supplemented—100% penalty (Section 6672), Charles Corporation, Tas-Tee Catering and Tas-Tee Vending withholding tax and withheld FICA*

In Section 6672, Congress has provided the Internal Revenue Service with an extraordinary collection tool. A responsible officer can be held *personally* liable for payment of a corporate debt. Congress has declared that an employer must withhold federal income tax and social security from payrolls. Such withheld funds become *trust* monies for which the employer is merely a custodian until

paid. The claimed failure by debtor to pay such trust funds (withholdings) must have been *willful*. Congress in its wisdom granted a responsible officer such protection.

The Courts have long recognized the requirement of proof of willfulness in Section 6672 cases. One of the outstanding cases is *Ferguson, et al. v. Warren*, 63-2 USTC ¶9783 (W. Dist. Wash., 1963). This case involved a suit for refund of taxes paid under a 6672 assessment. The jury returned a verdict in favor of the taxpayer-plaintiffs and found that they did not willfully fail to pay the Government income and social security taxes withheld by a corporation. In its charge, the Court stated:

> ". . . The responsible person must have known the taxes were due and consciously and deliberately disregarded payment of them, having funds within his control with which to do so. . ."

When and how were the claimed withholding tax liabilities incurred? The claim (adding the three companies together) shows the following:

$313,740—Total claim

$26,974 is reported as due on *2nd quarter 1968*.

Debtor took control on January 31, 1969. The exhibits and testimony showed, as of that date, there were *no liquid assets—no escrow accounts or tax depository accounts*. In fact, there was *no evidence* by the claimant that the $26,974 had been withheld. Obviously, if the funds had been withheld, they had been used long before by prior management.

$150,362 is reported as due on *4th quarter 1968*.

Debtor's management was not in the companies in those months. Again, *all the evidence* demonstrates

that by the time debtor took control, any withheld tax funds or any other liquid assets were long gone.

$?—January, 1969.

Internal Revenue Service has not provided a breakdown on this period of time during which the companies failed to deposit or otherwise hold the withheld taxes for payment. Again, *debtor had no responsibility under Section 6672 during January to withhold and had no control of such monies*—none were on hand on January 31, 1969.

Is the debtor liable for the above withholdings under some theory other than as a "responsible" officer during those periods?

Section 6672 is the basis of this claim and is silent as to any basis other than responsible person who willfully fails to pay over such funds. Again, *DEBTOR WAS NOT A RESPONSIBLE OFFICER PRIOR TO JANUARY 31, 1969, AND AT THAT DATE CONTROLLED NO SUCH TRUST FUNDS.*

Did debtor assume some contractual liability with Internal Revenue Service by signing the 4th quarter 941 return and by signing company checks on overdrawn accounts? The 941 form, the checks, and the total evidence presented by claimant supports no such assumption of contractual liability and no such contractual liability set forth in this claim nor in Section 6672.

Computed from the claim on file, *at least* $177,336 of this claim *IS ON WITHHOLDING DURING 1968*. That leaves approximately $137,000 for all of 1969, and some undetermined amount of the $137,000 represented January, 1969, withholdings. How much of the $137,000 was *employer's FICA* tax covered by application of *employees'* withholdings?

One matter was made clear by James McLaughlin, the Internal Revenue agent—But for his application of funds paid after February 1, 1969, to corporate share of FICA, *there would have been no withholding tax deficiencies subsequent to February 1, 1969.*

Examination by debtor's counsel of Internal Revenue Service of amounts of withholding tax withheld after February 1, 1969, demonstrated such total as $253,533. This was the total *trust* money withheld as both income tax and employees' FICA, and this was the total required to be withheld under debtor's management.

Debtor's evidence and Internal Revenue Service testimony showed *$249,212 was actually paid by debtor's management.*

$253,533—withholding liability

$249,212—withheld and delivered to Internal Revenue Service

The above figures standing alone are startling, overwhelming and convincing proof that debtor established a system of withholding, segregating, and paying the withholdings and that the system was followed.

Amid times of the most extreme financial stress and chaos imaginable, debtor's team withheld the taxes, set them aside in special accounts and delivered the funds to Internal Revenue Service.

The above comparison is most impressive to demonstrate *willfulness to pay* when compared to the corporate records of total *NONwithholding* and *NONpayment* in 4th quarter 1968 and January, 1969.

Debtor's testimony together with testimony of government witnesses, Mr. Molchan and Mr. Surckla, showed

that the withholding funds were delivered to Internal Revenue Service with the common understanding and agreement that these were withheld funds—trust funds—and were being delivered in that form and to cover those liabilities. The government is certainly bound by its own testimony.

As to application of these withholding monies, it is clear from all the testimony of Mr. McLaughlin and from the law that the withholding monies should be applied to withholding liability in accordance with the understanding of the officers of Tas-Tee and Internal Revenue Service. Mr. McLaughlin followed this understanding on several occasions and did apply funds to withholding liability, although there existed at that same time, extensive corporate liability for employer's FICA as well as prior withholding tax liability. He followed this understanding and agreement in several major payments of the funds segregated, levied upon and released and voluntarily paid from the Lake County National Bank depository.

The Court in *Hewitt v. United States*, 377 F. 2d 921, (1967), United States Court of Appeals Fifth Circuit held, in very broad terms, that absent any agreement, direction, or request, the Internal Revenue Service had a right to apply funds of a corporation as it saw fit to federal income and social security taxes which had been withheld from employees.

It was obvious from the testimony of government witnesses (Mr. Molchan and Mr. Surckla), that there was such an understanding, agreement, and request to Internal Revenue Service for application of the withholding taxes to current withholding liabilities.

If the Internal Revenue Service chose, in its wisdom, to make an application of withholding funds to nonwith-

holding liabilities, it did so purely as a collection procedure. Its actions, as such, would not in any event vary or affect in any way the obvious willful intent and willful action taken by debtor and his management *to pay the withholdings liabilities*.

> "An act is willful if it is voluntary, conscious and intentional. If you find the plaintiff voluntarily, knowingly and intentionally used available funds to prefer other creditors over the United States, then you must find that he acted willfully."
>
> *Monday v. United States*, 421 F.2d 1210, 72-1 USTC 9219 (E. Dist. Wisc., 1972).

The above is a statement of law given by the Court in its charge on a 6672 case.

The evidence presented by the government and by debtor showed:

1) That the debtor was in no way responsible for nonwithholding or nonpayment of withholding funds prior to February 1, 1969, as there were no such funds, or for that matter, any funds whatsoever existing upon debtor's arrival at the company;

2) After February 1, 1969, debtor's management *withheld* employees' income tax and FICA and paid such withholdings to Internal Revenue Service;

3) At no time did debtor voluntarily, knowingly, and intentionally use withholding or other available corporate funds to prefer other creditors over the United States; and

4) Debtor, by his instructions and procedures, demonstrated a *willfulness to withhold to account for* and *to pay over* the withholding taxes.

The claimant has failed in its burden to prove a willful failure to pay the withholding liabilities.

Does Section 6672 of the Internal Revenue Code impose a nonallowable "penalty" for purposes of the Bankruptcy Act? The effect of this Section is to penalize the bankrupt, or, in the instant case, the debtor; and although the Section itself provides that any responsible person who willfully fails to collect and pay over the withheld taxes is "liable to a *penalty* equal to the total amount of the tax . . . not accounted for and paid over," the actual purpose is not to penalize individuals, but to afford an alternative means of collecting a corporation's default in payment of employees' withheld taxes. The cases cited by the Government in its earlier brief of the subject, as well as its comments by way of post-trial memorandum, correctly reflect the law. Accordingly, it is not asserted that the claims should not be allowed by being designated as "100% penalty claims."

As to claim No. 80, on the basis of "third party beneficiary," for $229,511.58 for taxes due prior to February 1, 1969:

1) The contract between debtor and the four sellers is null and void and of no effect, by virtue of the dismissal with prejudice of the sellers' claims against debtor and the settlement agreement previously approved by the Court; and

2) Even if the contract was in effect, none of the selling shareholders in whose favor the "hold harmless" clause was written were ever considered liable under Section 6672 for withheld taxes by the Government, and thus, no right to recover from the debtor exists.

As to claim No. 29 for $445.69 for dental practice withholding, the testimony clearly established that this sum had been long paid and that nothing is due.

As to claim No. 29 for withheld taxes:

1) The debtor was not responsible for collection of withholding taxes until February 1, 1969. On that date there were no funds on hand for said purpose as the former owners had failed to withhold or segregate sufficient funds;

2) The debtor established a system of segregating funds for payment of withheld taxes and did, in fact, pay withheld taxes during the period February 1, 1969, to July 15, 1969;

3) *There was no willful failure* to pay over taxes as the evidence clearly indicated that the debtor, as a responsible person, and the officers of the employer-corporation *PAID THE WITHHOLDINGS* and had attempted to make it perfectly clear to the Internal Revenue Service that the payments were for current trust fund obligations. While this intention to pay was disclosed, the Government applied the funds as it saw fit contrary to said expressed intent; and

4) The mere act of signing 941 returns for periods prior to February 1, 1969, is not sufficient to render the signer liable as a responsible person under Section 6672.

Conclusion

The evidence disclosed that claim No. 80 in the amount of $229,511.58 is based soley on the contentions of the United States of America that it is a third party beneficiary under stock sale agreement of Russell's Foods, Inc, dated January 31, 1969.

The United States relied entirely on its claim as filed offering no additional evidence thereon.

Debtor produced evidence of agreement by all parties to such stock purchase contract that such stock purchase contract had been deemed null and void and of no effect and that the suit filed by the parties to the contract had been dismissed with prejudice. Debtor further testified that he and the parties signatory to the contract had no intent to benefit the United States of America. The United States offered no evidence or testimony contrary to debtor's evidence.

The contract wording further reflects no intent to benefit the United States of America. The United States further offered no evidence of payment of taxes by any of the parties to the stock contract and no evidence that any of such parties were responsible persons required to pay withholding taxes. Accordingly, there was, in any event, no showing of liability of debtor through operation of the purported indemnification clause.

The Court, therefore, sustains the debtor's objections as to claim No. 80.

Coming now to claim No. 29 as amended October 15, 1973, the Court notes that such claim is in the total amount of $313,740.79, of which sum $445.69 is attributable to Ike Slodov, employer No. 34-0909176, and claimed as a nonpayment of withholding and FICA for 4th quarter 1969.

The United States of America, claimant, relied entirely on its claim as filed together with claimant's Exhibit 1 entitled "Certificate of Assessment and Payment."

Debtor testified nothing was due nor had he ever been notified nor billed concerning the claimed deficiency and that all of his personal and professional tax returns had been audited through the year 1970 and prior with a finding that there was due debtor the sum of $6,674.85, which is verified as a credit to debtor on claimant's Exhibit 1. In addition, debtor's accountant, who had personally participated in such audit, testified that all 941 withholding tax returns including 4th quarter 1969 had been reviewed and audited by an agent of the Internal Revenue Service with no finding of irregularity, no deficiency, and in fact, that there had been found due debtor from Internal Revenue Service the above-mentioned $6,674.85.

The remainder of claim No. 29 is founded upon Section 6672 of the Internal Revenue Code, which provides:

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

The testimony established that debtor and his management assumed control of the Russell's Foods companies after January 31, 1969, together with its bank accounts.

As to all withholding taxes prior to January 31, 1969, debtor was not a responsible officer or person charged with withholding and paying such taxes. His act of signing 941 withholding tax returns for 4th quarter 1968 and of signing checks to pay such taxes do not, under these circumstances, render him such a responsible person.

Prior to January 31, 1969, any taxes withheld had been spent on corporate debts or otherwise as shown by the negative bank balances at the date debtor wrote the several checks to Internal Revenue Service. Accordingly, at January 31, 1969, it is clear that there were no withholding trust fund tax monies or other funds over which debtor could assume control or responsibility.

The Court finds that as to payroll withholdings on or after February 1, 1969, and continuing to around July 15, 1969, debtor was the responsible person pursuant to Section 6672.

The Court further notes, however, that Section 6672 specifies that failure to withhold or pay over such withholdings must have been *willful*.

The following are a number of circumstances and evidentiary matters which have led this Court to a conclusion that there has been no willful nonpayment of withholding taxes:

1) After February 1, 1969 (and apparently for some time prior thereto), the entire corporate and financial situation of the subject companies was in a constant and serious state of turmoil. There was a history of suits, replevins, levies, and repossession threats and signers of bank accounts which enveloped the companies at the time of debtor's assuming control. Counsel for the United States during his examination of debtor appropriately termed the company affairs as a "horror story." Debtor was, therefore, working under the worst of possible conditions for obtaining a clear understanding of financial conditions and tax liabilities.

2) This Court is impressed with the record of payment of the companies after February 1, 1969. The fol-

lowing are the specific payments as shown from the exhibits and record of testimony taken by the Court:

TAS-TEE CATERING, INC.

PAYMENTS

Date (1969)	Amount
Various	$54,144.15
8-11	795.76
4-11	5,000.00
2-11	4,024.67
2-14	7,968.20
2-14	3,173.11
4-11	5,000.00
4-22	4,000.00
4-21	10,000.00
4-25	15,924.00
4-29	7,728.00
5-12	21,020.08
5-26	2,256.43
5-20	8,000.00
5-26	4,070.22
6-3	8,841.55
6-4	9,000.00
6-24	7,880.32
7-2	7,080.15

TAS-TEE VENDING, INC.

PAYMENTS

Date (1969)	Amount
5-27	$5,180.00
6-3	1,261.73
6-3	1,275.48
6-24	1,428.18
7-2	765.69

CHARLES CORPORATION

PAYMENTS

Date (1969)	Amount
2-11	$ 4,348.60
2-14	4,958.44
3-18	9,558.48
4-21	5,000.00
4-25	8,926.14
4-29	2,742.03
5-12	13,029.91
5-12	3,340.91
5-26	1,673.35
6-4	5,380.00
6-3	4,049.43
6-3	4,000.00
6-24	4,054.08
7-2	3,705.94

3) The Court notes that during February and March withholding taxes were being accumulated in a special depository at Lake County National Bank and that such depository was disclosed to Internal Revenue Service agents at the earliest possible time.

4) The testimony of the two corporate officers (Mr. Surckla and Mr. Molchan) who were Government witnesses, showed direct and firm instructions voiced by debtor to pay the withholding taxes.

5) The testimony of Mr. Surckla and Mr. Molchan vividly corroborated testimony of debtor as to the enormous effort of corporate employees to pay over such withholding taxes under circumstances where Internal Revenue Service would not accept corpo-

rate checks nor delivery of cash but insisted upon certified drafts. Corporate employees expended considerable time, effort, and risk in carrying carloads of cash to various financial institutions for purposes of counting and converting cash to certified drafts.

6) The testimony further showed that neither Mr. Surckla nor Mr. Molchan had been pursued by Internal Revenue Service as responsible persons under Section 6672 for personal payment of such taxes. Therefore, the Court notes that their testimony as to instructions and efforts to pay over such taxes is clearly nonself-serving and, as a result, left the claimants with a shallow case.

7) In addition to the above payments and attempts at payment, the evidence showed debtor immediately after February 1, 1969, contacted Internal Revenue Service and advised its agents of the discovery of the dire financial circumstances and solicited assistance or guidance from Internal Revenue Service.

Claimant has contended that payment of any other corporate debts after February 1, 1969, demonstrates willfulness of debtor to avoid payment of taxes. The Court notes that the decisions cited by claimant and by debtor refer to voluntarily, knowingly, and intentionally using available funds to *prefer* other creditors over the United States. The Court further notes that the payments shown of particular large amounts by claimant were with debtor's personal funds or personal funds deposited with the corporations by debtor. It is obvious that many bills incurred in the continuing operation of the corporations were paid for day-to-day expenses, it being noted that suppliers had

placed the companies on a C.O.D. supply basis. There is no evidence that any creditor was preferred nor were they paid on arrearages. It should also be noted that Internal Revenue Service knew as early as the first week in February, 1969, that the corporations were in arrears in paying withholding to a sizeable amount. Internal Revenue Service knew that the companies were continuing in their operations and that it was necessary to purchase and pay for daily merchandise and other expenses.

The weight of the evidence shows an intent by debtor to pay over withholding taxes. The evidence may show nonpayment of some withholdings in small amounts after February 1, 1969, small amounts as compared to the entirety of withholding. It is clear to the Court that any such nonpayment was not willful.

The attorney representing Internal Revenue Service, Mr. Richard F. Mitchell, made a statement in open Court that the entire transaction of the sale of Tas-Tee Catering and affiliating companies to Doctor Slodov was a "horror story."

The Court therefore sustains the objection to claim No. 29.

Attorney for the debtor will cause a Journal Entry to be prepared giving expression to this decision. Submit the same to opposing counsel before submitting it to the Court, reserving therein exceptions.

/s/ DON C. MILLER
Bankruptcy Judge

JUDGMENT OF THE DISTRICT COURT

(Filed September 9, 1974)

Case No. B70-4787

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN THE MATTER OF:

IKE SLODOV,
Debtor

In Proceedings for a Real Property Arrangement
Under Chapter XII

JUDGMENT

At Cleveland, in said District, this 9th day of September, 1974.

This cause came on to be heard upon the Debtor's Objections to Claim Nos. 29 and 80, as filed, amended and supplemented by Internal Revenue Service, the statements of counsel, briefs of law and the evidence. The issues having been duly considered, and a decision having been duly rendered.

IT IS, ORDERED AND ADJUDGED that the Objections of the Debtor to Claim Nos. 29 and 80, as filed, amended and/or supplemented by Internal Revenue Service, be and the same are hereby sustained, and judgment is rendered in favor of the Debtor thereon.

/s/ DON C. MILLER
Bankruptcy Judge

MEMORANDUM OPINION AND ORDER OF THE DISTRICT COURT

(Filed September 8, 1975)

No. B 70-4787

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN THE MATTER OF:

IKE SLODOV,
Debtor

MEMORANDUM OPINION AND ORDER

LAMBROS, *District Judge*

This matter is presented for review of a decision denying the claims of the United States relating to a bankrupt debtor's withholding and F.I.C.A. taxes, the obligations arising from his orthodontia practice and from sums due under 26 U.S.C. §6672, the penalty provision[1] allowing assessment of taxes against an officer of a corporation.

The questions presented for review are these:

1. Was the debtor liable for withholding and F.I.C.A. taxes for the fourth quarter of 1969, in the amount of $445.69?

2. Was the debtor responsible for payment of federal withholding (trust fund) taxes for the second quarter of 1968 and the fourth quarter of 1968, as

1. The provision is not a penalty *per se* but rather an alternative tax collection device.

owed otherwise by Tas-Tee Catering, Inc., and related companies, and was his failure to pay willful?

3. Was the failure of the debtor to collect and to pay over federal withholding (trust fund) taxes owed by Tas-Tee Catering, Inc., and related companies during the period from February 1, 1969, through July 15, 1969, a *willful* failure?

4. Was there any agreement or understanding between the Internal Revenue Service and the debtor to the effect that moneys paid to the Internal Revenue Service would first be applied to the withholding portions of federal employment taxes, and if so, is that agreement enforceable in this proceeding?

I. QUESTION 1 FOR REVIEW

This claim is factually distinct from those raised in the other questions presented. The claimant seeks to recover $445.69 due as withholding and F.I.C.A. taxes for the fourth quarter of 1969, the obligation having its origin in the debtor's dental practice. The Government contends that the Bankruptcy Judge incorrectly placed the burden of proof upon the United States as a claimant and that the evidence presented was insufficient to sustain the findings made by the Bankruptcy Judge.

The Court finds that the burden of proof is properly placed on the Government when it seeks to collect a tax. The assessment of taxes is sufficient to establish a prima facie case forcing the debtor to go forward with evidence to rebut, but the United States as a claimant seeking to collect taxes has the burden of proof. *Bar L. Ranch v. Phinney*, 426 F.2d 995 (5th Cir. 1970); 3A *Colliers on Bankruptcy* §64.409. This was the standard applied by the Bankruptcy Judge and upon review of the evidence

this Court cannot hold that the decision of that Judge based on the evidence presented to him was improper. *In re Mascolo*, 505 F.2d 274 (1st Cir. 1974).

The Bankruptcy Judge's decision on this issue is affirmed.

II. QUESTIONS 2, 3 AND 4 FOR REVIEW

The other three issues presented for review herein arise from the same factual background which in relevant part is as follows:

> Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee Vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.
>
> During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient money in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately.

Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.

. . .

The Internal Revenue Service filed its proof of clai for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:

> 'Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828).'

Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,511.58, supplemental to proof of claim No. 29 filed on November 2, 1970. *Opinion, Date July 1, 1974, Pages 1 and 2.*

A. *Question 2*

The Government contends that the Bankruptcy Judge applied the wrong standard in determining whether or not the debtor's conduct was "willful" within the meaning of §6672. The Government is correct that the decision as to "willfulness" is not dependent on whether the responsible corporate official acted in bad faith or with improper motives. The test for "willfulness" in regard to §6672 is only whether or not the corporate official decided voluntarily not to pay the taxes owing. *Dudley v. United States,* 428 F.2d 1196 (5th Cir. 1970); *Bloom v. United States,* 272 F.2d 215 (9th Cir. 1959), *cert. den.* 363 U.S. 803. To the extent the Bankruptcy Judge applied another standard, his decision is reversed.

However, the Court finds that there is a more important issue which appears in the facts presented and which facts are not disputed by the parties. The debtor had no role in the corporations until January 31, 1969. He had no control over financial decisions. He had no opportunity to collect or direct collection of the taxes as they accrued. And therefore, under the clear and unequivocal language of §6672, he is not a "person required to collect, truthfully account for and pay over any tax. . . ." As the Court of Appeals for the Fifth Circuit observed in *McCullough v. United States,* 462 F.2d 588 (1973):

> The government here contends for a position which would, in effect, change the language of Section 6672 from 'person required to collect, truthfully account for, and pay over' to 'person required to collect, truthfully account for, or pay over.' The government thus seeks to fix liability on R.F. McCullough because he was president of the corporation during a time when sufficient funds came into the corporation's coffers,

which, in cumulative amount at least would have been sufficient to discharge the corporation's liability for the unpaid taxes. The principal difficulty with this argument is that this is not the way the statute is written and there is no statutory authorization for the collection of this penalty, even though the taxpayer had free funds available for the purpose of paying the taxes. *McCullough, supra,* at 590.

Accordingly, the Court affirms the finding of the Bankruptcy Judge that the debtor is not liable under §6672 for the taxes arising during the 2nd and 4th Quarters of 1968, or during January 1969.

B. *Question 3*

The Government also seeks review of the Bankruptcy Judge's findings that the debtor did not act willfully in failing to pay the taxes due from February 1, 1969 through July 15, 1969. The Court, as noted in the preceding section, finds that the proper test for "willfulness" is whether or not the debtor voluntarily chose to pay creditors other than the United States. *Monday v. United States,* 421 F.2d 1210 (7th Cir. 1970), *cert. den.* 400 U.S. 821; *Werner v. United States,* 374 F. Supp. 558 (D.Conn. 1974); and *Stake v. United States,* 347 F. Supp. 823 (D.Minn. 1972).

From the evidence presented, the Court finds that the debtor did voluntarily elect to pay other creditors instead of the United States and for that reason, his conduct constituted a "willful" violation of the obligations imposed upon him.

The determination made by the Judge that the debtor's conduct was not "willful" as that term is used in §6672 is therefore reversed.

C. *Question 4*

The Government's final question for review is whether the Bankruptcy Judge's findings that there was in existence an agreement between the Internal Revenue Service and the debtor as to how the payments were to be applied were proper.

The taxes in question are employment taxes, which have both an employee and an employer share. The reach of §6672 is only to the employee's share, for it is only that portion the employer is obligated to collect and pay over, standing in a trustee-like relationship to the employee and to the Government.

Assuming that finding was an agreement as to the designation of the payments during 1969, this designation involved only the corporation, not its officers. The personal liability of the officers is in no way dependent on agreements with the employer corporation. *Monday, supra*; *cf., Spivak v. United States,* 370 F.2d 612 (2nd Cir. 1967), *cert. den.* 387 U.S. 908.

To hold otherwise would allow the officers of a corporation to convert those trust funds to business purposes and still avoid any personal liability. The intent of Congress to impose responsibility on corporate officers in charge of employment taxes is clear, and may not be frustrated by agreements involving the corporate employer.

The decision of the Bankruptcy Judge as to this issue is accordingly reversed.

III. CONCLUSION

The Opinion of the Bankruptcy Judge, entered July 1, 1974, is affirmed in part and reversed in part. The Court remands the case for further proceedings, to include recomputation of the debtor's obligation for 1969, the Court

having found him not personally liable for the employment tax obligation arising in January 1969. The Court would further note that the claimant's contention that only $233,-056.31 was paid on the 1969 obligations appears correct, the other $10,795.76 having properly been applied to 1968 corporate obligations. Thus further recomputation will be required to determine the exact sum owed to the claimant.

IT IS SO ORDERED.

/s/ THOMAS D. LAMBROS
United States District Judge

JUDGMENT OF THE DISTRICT COURT

(Filed September 9, 1975)

No. B 70-4787

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN THE MATTER OF
IKE SLODOV,
Debtor

JUDGMENT

LAMBROS, *District Judge*

In accordance with the decision in the Memorandum Opinion and Order entered this date, this case is remanded to the Bankruptcy Court for further proceedings.

IT IS SO ORDERED.

/s/ THOMAS D. LAMBROS
United States District Judge

OPINION AND JUDGMENT OF THE COURT OF APPEALS

(Filed April 5, 1977)

No. 75-2496
No. 75-2497

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

IN THE MATTER OF SLODOV, DEBTOR IKE SLODOV,
Appellant and Cross-Appellee,

v.

UNITED STATES OF AMERICA on behalf of the INTERNAL REVENUE SERVICE,
Appellee and Cross-Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION.
Decided and Filed April 5, 1977.

Before: EDWARDS, CELEBREZZE and LIVELY, *Circuit Judges.*

LIVELY, *Circuit Judge.* These consolidated appeals concern the personal liability of a controlling officer of a corporation for income taxes and social security taxes withheld from the wages of employees but never paid over to the government. The controlling officer is now the debtor in proceedings for a real property arrangement under Chapter XII of the Bankruptcy Act. The following statement of the case appears in the opinion of the Bank-

ruptcy Judge, 74-2 USTC § 9719, adopted by the district court in its memorandum opinion, 75-2 USTC § 9829, following a petition for review:

> Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee Vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.
>
> During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient money in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately. Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.
>
> . . .

The Internal Revenue Service filed its proof of claim for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828)."

> Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,511.58, supplemental to proof of claim No. 29 filed on November 2, 1970.

The claim of the United States related to two distinct periods, one covering income taxes and social security taxes withheld from wages of employees ("trust fund taxes") prior to January 31, 1969 and the other being concerned with such taxes withheld after Dr. Slodov took control of Tas-Tee Catering on that date. Claim No. 29 encompassed both time periods, and the Bankruptcy Judge sustained Slodov's objections to that claim in its entirety.

Upon review, the district court affirmed the order of the Bankruptcy Judge with respect to that portion of Claim No. 29 which related to taxes withheld by Tas-Tee Catering prior to the time that Slodov took control, but reversed the order with respect to taxes withheld after control passed to him. Both parties have appealed.

SLODOV'S APPEAL

The taxpayer asserts that the district court erred in holding that he is liable for trust fund taxes of Tas-Tee Catering for the period from February 1, 1969 to July 15, 1969. This claim of error has two bases—first, that it is clear from the evidence that Slodov caused the corporation to collect, truthfully account for and pay over all trust fund taxes due to the United States for the period after January 31, 1969 during which he controlled the affairs of the corporation; and second, that there was an agreement between the Internal Revenue Service and the corporation by which payments during this period were to be applied to the current liability of the corporation for income taxes and social security taxes withheld from the wages of employees. The taxpayer testified at length concerning an agreement for the application of payments, and his testimony was supported by that of two former Tas-Tee Catering employees who were called by the government. The IRS agent in charge of the case testified that no such agreement existed and that if it did exist, IRS was not bound by it. He applied some of the payments to other tax liabilities of the corporation, including the employer's share of social security taxes.

The Bankruptcy Judge found that the total payments from Tas-Tee Catering to IRS during the period February 1, 1969-July 15, 1969 were virtually identical with the total liability for the corporation for trust fund taxes dur-

ing that period and that except for the decision of an IRS agent to apply these payments to the corporate share of social security taxes, ". . . there would have been no withholding tax deficiencies subsequent to February 1, 1969." The Bankruptcy Judge also found that the payments made by Tas-Tee Catering to IRS during this period were made pursuant to ". . . an understanding, agreement, and request to Internal Revenue Service for application of the withholding taxes to current withholding liabilities." Even though the IRS agent testified that he was not bound by an agreement for the application of payments by a taxpayer, it is undisputed that several of the payments were applied in accordance with the agreement at a time when the corporation had extensive liability for its own share of current social security taxes as well as withholding tax liability for previous periods. The Bankruptcy Judge concluded from these findings that the trust funds taxes which accrued during the period of Dr. Slodov's control of Tas-Tee Catering were paid in full and that payment of other corporate debts during this period was not evidence of willful failure to pay withholding taxes since there had been no showing that corporate funds were intentionally used to prefer other creditors over the United States.

In reviewing the decision of the Bankruptcy Judge the district court did not refer to the finding that all trust fund liability of the corporation during the period of Dr. Slodov's control had been paid in full. With respect to an agreement between IRS and the corporation, the district court held that if such an agreement did exist it would not affect Dr. Slodov's individual liability under Section 6672. The main thrust of the district court's holding was to the effect that the Bankruptcy Judge applied an incorrect legal standard in determining whether or not Dr. Slodov's conduct in paying other debts of the

corporation was willful within the meaning of Section 6672. Though the government contended otherwise in the district court, it now concedes that a designation by a taxpayer as to how a voluntary payment of taxes is to be applied is binding on the Internal Revenue Service. It continues to argue, however, that there is no evidence of an agreement between Tas-Tee Catering and IRS as to the application of payments and no evidence that a request was ever conveyed to personnel of IRS that the amounts paid should be applied first to the current trust fund liabilities of the corporation. It maintains that the findings of the Bankruptcy Judge are clearly erroneous.

If the district court had considered the findings of the Bankruptcy Judge, review would have been subject to Rule 810, Federal Rules of Bankruptcy, which provides:

> Rule 810. Disposition of Appeal; Weight Accorded Referee's Findings
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> Upon an appeal the district court may affirm, modify, or reverse a referee's judgment or order, or remand with instructions for further proceedings. The court shall accept the referee's findings of fact unless they are clearly erroneous, and shall give due regard to the opportunity of the referee to judge of the credibility of the witnesses.

In *McDowell v. John Deere Industrial Equipment Co.*, 461 F.2d 48, 50 (6th Cir. 1972), we held that it is firmly established in this circuit that findings of fact of a Referee in Bankruptcy (now Bankruptcy Judge) should not be disturbed by a district judge unless there is "most cogent evidence of mistake or miscarriage of justice." A review of the evidence heard and received by the Bankruptcy Judge discloses ample support for his findings both with

respect to the existence of an agreement for the application of the payments in question to current trust fund liabilities and that designations accompanied specific payments.

If the Internal Revenue Service had honored the agreement and designations found to exist by the Bankruptcy Judge, the corporation's liability for income taxes and social security taxes withheld from the wages of its employees during the period from February 1, 1969 to July 15, 1969 would have been satisfied. Since the payments by Tas-Tee Catering during the period of Dr. Slodov's control were virtually identical with the corporation's liability for trust fund taxes withheld during that period and these payments were made pursuant to an agreement that they be applied to current trust fund liability, Section 6672 of the Internal Revenue Code never came into play. The purpose of Section 6672 is to provide an additional remedy for the government in the form of a "penalty" tax against individuals responsible for the failure of a corporation to satisfy its tax liabilities. An individual who has caused the corporate obligations for trust fund taxes to be paid may not be held personally liable under Section 6672 because the IRS chooses to ignore a binding agreement and credits these payments to other corporate tax liabilities. *McKenzie v. United States*, 536 F.2d 726 (7th Cir. 1976).

THE CROSS-APPEAL

The district court affirmed the holding of the Bankruptcy Judge that Dr. Slodov is not liable under Section 6672 for income taxes and social security taxes required to be withheld by Tas-Tee Catering from the wages of its employees prior to January 31, 1969. The Bankruptcy Judge found from the testimony and exhibits that as of the date on which Dr. Slodov took control the corporation

had no liquid assets and there were no escrow accounts or tax depository accounts. The Bankruptcy Judge held that Slodov was not a "responsible officer" prior to January 31, 1969 and that on that date no trust funds came into his control. In affirming the holding that Dr. Slodov was not liable under Section 6672 the district court stated:

> The debtor had no role in the corporations until January 31, 1969. He had no control over financial decisions. He had no opportunity to collect or direct collection of the taxes as they accrued. And therefore, under the clear and unequivocal language of § 6672, he is not a "person required to collect, truthfully account, [sic] for any pay over any tax. . . ."

The district court cited *McCullough v. United States*, 462 F.2d 588 (5th Cir. 1972), in which the court held that a person who had no responsibility for the collection of or accounting for taxes withheld during a particular period but who later controlled the corporation could not be held personally liable under Section 6672 for failure to pay the taxes to the government. However, we do not find *McCullough* to be dispositive of the issue on cross-appeal. The *McCullough* court found that the taxpayer never had available unencumbered funds with which to pay taxes that had previously been withheld and not paid over to the government. The court stated that it therefore did not "decide the liability of a person who becomes an officer responsible for the payment of withheld but not accounted for and not paid withholding and FICA taxes at a time when the corporation has funds from which the managing head of the corporation could discharge the defaulting corporation's trust obligation to the government and exercises his control to disburse such funds for other purposes." *Id.* at 590. The evidence is undisputed that Tas-Tee Catering had in its possession

during the period of Dr. Slodov's control large sums of money which it used to pay debts and operating expenses. Therefore we must decide the question not reached by the Fifth Circuit in *McCullough*.

There is no doubt in the present case that Dr. Slodov knew that withheld taxes for periods prior to his taking control were unpaid. He attempted to pay these taxes with a corporate check immediately after assuming responsibility for the affairs of Tas-Tee Catering and later stopped payment on the check when he discovered that there were no funds at that time to make the check good or to pay other obligations of the corporation. In seeking affirmance of the district court on this issue the debtor argues that if funds representing taxes previously withheld by the corporation never came into his hands as a subsequent responsible party and no funds were available at the time he became the person in control of the corporate affairs, he may not be held liable under Section 6672. The government contends that there is no distinction between the position of a taxpayer who takes control of a corporation which has withheld taxes in its possession and dissipates them for other purposes and one who takes over such a corporation with no funds and uses money subsequently acquired by the corporation to pay other obligations to the detriment of the government.

An employee's income tax account and social security account are credited with the amounts reported by the employer as withheld for these purposes whether the employer pays them over to the government or not. The taxes required to be collected or withheld are intended by Congress to be treated as special funds held in trust for the United States. 26 U.S.C. § 7501; *Harrington v. United States*, 504 F.2d 1306 (1st Cir. 1974); *Spivak v. United States*, 370 F.2d 612, 615 (2d Cir.), *cert. denied*, 387 U.S.

908 (1967). The "willfulness" required for personal liability under Section 6672 exists if those with power and responsibility within the corporate structure for seeing that taxes which have been withheld are remitted to the government, acting voluntarily, consciously and intentionally, use corporate funds to pay other obligations rather than using them to pay withheld taxes. *Harrington* v. *United States, supra,* 504 F.2d at 1311; *Monday v. United States,* 421 F.2d 1210 (7th Cir.), *cert. denied,* 400 U.S. 821 (1970).

The Ninth Circuit dealt with a case similar in many respects to the present one in *Teel v. United States,* 529 F.2d 903 (1976). There responsible officers were found to have known that there were arrearages in payments of income and social security taxes in previous quarters, but they continued the operation of the business, using funds generated from the sales of inventory and manufactured products to pay for new merchandise. The court held that they acted willfully in failing to pay the taxes, stating ". . . as the cash went into the cash drawer, it became subject to trust or lien in favor of the federal government for the unpaid withholding taxes. By dissipating the cash for new purchases, of which the taxpayers knew, they unwittingly supplied the necessary willfulness." *Id.* at 905. *Teel* differs from the present case in that the taxpayers were responsible officers both during the time when withholding was required and when payment was due. However, we do not agree with those decisions which have indicated that personal liability under Section 6672 may only be incurred by persons who are responsible parties at the time withholding or collection is required to be effected as well as when reports and payments are required to be made. *See McCullough v. United States, supra,* 462 F.2d at 590.

We conclude that it is irrelevant whether there were unencumbered funds on hand at the time Dr. Slodov took control of Tas-Tee Catering. Prior to that time the employees of the corporation had received net wages which reflected withholding for income taxes and social security taxes. Whether these withheld taxes were segregated and held in special accounts or not they became trust funds for the payment of the withholding obligations of the corporation to the United States. When the corporation came into possession of funds after Dr. Slodov acquired control, these funds were impressed with a trust to the extent of the corporation's obligations for previously unpaid withholding income taxes and employees' share of social security taxes. Though created before Dr. Slodov's control of the corporation began, these obligations continued after that date, and he was clearly the person responsible for paying them when funds became available. In a different context this court has considered the meaning of the word "person" as it is defined in 26 U.S.C. § 6671(b) and referred to in § 6672. In *Mueller v. Nixon,* 470 F.2d 1348 (6th Cir. 1972), *cert. denied,* 412 U.S. 949 (1973), we decided to adopt a "broad interpretation" of the word "person" in order to give the full meaning to the intention of Congress. In the *Mueller* opinion the court quoted Section 6672 and then stated:

> As we read this section, it is squarely addressed to the person or entity responsible for the payment of the withheld taxes. It is knowledge of the tax delinquency and authority over the decision to pay or not to pay the taxes which is at issue—not who has the duty of filling out the forms. *Id.* at 1350.

Dr. Slodov clearly knew that Tas-Tee Catering had not paid income taxes and social security taxes withheld from the wages of its employees prior to the date that

he took control of the corporate affairs, and when he caused subsequently acquired funds to be used for satisfaction of other corporate debts and payment of operating expenses instead of paying these preexisting obligations he exposed himself to personal liability under Section 6672. As the court stated in *Braden v. United States*, 442 F.2d 342, 344 (6th Cir.), *cert. denied sub nom. Bonistell v. Braden*, 404 U.S. 912 (1971)—

> If the appellant was aware of the fact that the taxes were unpaid, and, possessing the power and responsibility to pay them, failed to do so, then he is liable for the penalty of section 6672 notwithstanding his lack of malice or wrongful purpose. (Citations omitted).

It is immaterial that he was not in control of the corporation at the time it paid the wages from which the income and social security taxes were deducted. He did not "truthfully account for and pay over such tax" and this rendered him personally liable for the amount of the taxes.

The judgment of the district court is reversed on the appeal and cross-appeal, and the cause is remanded for further proceedings.

ORDER OF THE SUPREME COURT OF THE UNITED STATES GRANTING PETITION FOR A WRIT OF CERTIORARI

(Dated October 3, 1977)

No. 76-1835

SUPREME COURT OF THE UNITED STATES

IKE SLODOV,
Petitioner,

v.

UNITED STATES.

ORDER ALLOWING CERTIORARI. Filed October 3, 1977.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Sixth Circuit is granted. The case is set for oral argument in tandem with No. 76-1800.